CONCENTRATED LEADERS FUND

ASX LISTED INVESTMENT COMPANY (TICKER: CLF) | MONTHLY INVESTMENT REPORT: MARCH 2019

Fund Description

Concentrated Leaders Fund Limited (CLF) is a concentrated portfolio of leading Australian companies. The CLF investment team uses a top-down macro thematic, quantitative filters and bottom-up fundamental research.

Fund Objective

CLF is a geared listed investment company, which invests primarily in companies within the S&P/ASX 200 Accumulation index. CLF is focused on providing investors with capital growth and a consistent yield.

Net Tangible Assets (NTA) as at 31 March

Total Investments	**$112,164,493**
NTA	**$81,001,291**
Shares on Issue	**59,401,545**
NTA per Share (pre-tax) *	**$1.36**
NTA per Share (post-tax)*	**$1.29**
Share Price	**$1.29**
(Discount)/Premium to NTA (pre-tax)	**(5.15)%**
(Discount)/Premium to NTA (post-tax)	**0%**
Fully Franked Dividend Yield	**6.64%**

* On realized and unrealised gains.

Fund Information

ASX Code	CLF
Date of launch	September 1987
Benchmark	S&P/ASX 200 TR Index

Service Providers

Custodian	National Australia Bank
Administrator	Fundhost Limited
Banker	National Australia Bank
Auditor	Deloitte Touche Tohmatsu
Legal Advisor	Watson Mangioni Lawyers

Contact Information

Telephone	+61 2 9357 0788
Email	info@clfund.com.au
Registered Office Address	2 Paddington Street, Paddington NSW 2021
Principal Office Address	Level 12, 37 Bligh Street, Sydney NSW 2000

Concentrated Leaders Fund Limited ABN 25 003 236 173

Portfolio and Market Review

Investment Performance

Performance as at 31/03/2019 **	1 Month	3 Months	6 Months	12 Months	Financial YTD	Since Inception *
CLF	-1.26%	10.40%	2.61%	10.50%	3.92%	8.96%
Benchmark	0.73%	10.89%	1.75%	12.06%	3.31%	7.74%
Value Add	-1.99%	-0.49%	0.86%	-1.56%	0.61%	1.22%

* Inception date reflects when management of the fund was internalized as of 1 January 2018
** Gross performance excludes all expenses, fees and taxes. Net performance is reflected in the NTA calculations.

The portfolio returned -1.26% on a gross basis (pre-fees and taxes) in March versus the benchmark return of +0.73%. This equates to a -2.86% decrease in pre-tax NTA and a -2.27% decrease in the post-tax NTA.

For the financial year to date, the portfolio has delivered a return of +3.92% on a gross basis versus the benchmark's +3.31%. This represents an outperformance of +0.61% in what has been a volatile environment for investors.

Market Review

The S&P/ASX 200 Total Return Index return of 0.73% during the month brings the performance for the benchmark for the calendar year-to-date to 10.89% and for the financial year-to-date to 3.31%.

The rally during the first quarter of the year has seen the S&P/ASX 200 Index completely erase the declines experienced in the fourth quarter of last year. The market's performance has been surprisingly strong despite a weaker macro environment and an unexciting earnings update season. As a result of the rally, the P/E multiple for the S&P/ASX 200 Index expanded to 15.5x at the end of March from 13.7x on 24 December 2018, which was the trough of the Q4 2018 sell-off.

The local market broadly underperformed its global peers during the month, although Asian equities (ex-China) in general were weaker than their US and European counterparts. In terms of sectors:

- **Real Estate (+6.0%)** benefitted from the global rally in fixed income securities which saw the Australian 10-year bond yield fall to a record low of 1.72%. **CHC (+16.7%)** was the strongest performer in the sector due to its high beta characteristics and an upsized raising for its Charter Hall Education Trust (CQE).
- **Telecommunications (+3.8%)** also rallied due to its perceived defensive and yield orientated nature. Sector heavyweight **TLS (+6.1%)** had a strong month to cap off a phenomenal quarter which saw its share price rally 16.5%.
- **Energy (-4.7%)** was the worst performing sector with **WHC (-8.0%)** leading the sector down with unofficial coal import restrictions in China weighing on the price of Thermal coal. Oil related stocks including **WOR (-5.0%), WPL (-4.8%)** and **OSH (-4.5%)** also dragged the sector down despite a continued rally in the price of crude oil. News that Norway's sovereign wealth fund was ceasing to invest in oil and gas companies due primarily to the country's structural overweight to the sector was the main driver behind lower stock prices.

Portfolio Review

The portfolio's underperformance last month comes after two strong months of outperformance to start the calendar year. The poor performance in March was driven by three things:

1. **A reversal of February outperformers** – Several portfolio companies reported excellent earnings updates during February and as a result rallied strongly. However, a number of them gave back some of these gains during March with **SVW falling 9.0%** (having rallied 22.6% in February), **WEB fell 7.0%** (+30.5% in Feb) and **APX fell 4.8%** (+46.7% in Feb). We actively took some profits in some of these companies, but the mean-reversion negatively impacted the portfolio none the less.
2. **An underweight position in REITs and Telecommunications** – These were the best two performing sectors last month and while we have a small exposure to REITs, we remain underweight given our negative view on domestic property (impacting developers) and retail spending (impacting shopping centers). In addition, we view current valuations to be unattractive with the price/book ratios for most of the major REITs expanded meaningfully over the last three months. In terms of Telecommunications, we have no exposure to the sector as we question the quality of the sector heavyweights and continue to think they face structural headwinds.
3. **A position in Eclipse Group (ECX)** – This was by far the largest detractor from performance during March with **ECX falling 67.6%** after announcing a 42% decline in net profits after tax for the first 5 months of FY18. As a result, it was also announced that the proposed merger with McMillian Shakespeare (MMS) would not be proceeding. The decline in operating conditions in such a short space of time (ECX updated the market on 29 January) came as a shock to the market. We had previously reduced our holding and thought we had sized the position appropriately (~1.5% position) given the macro risks the company faced, but obviously a fall of this magnitude had an outsized impact on the portfolio. The interesting thing about ECX was that its two largest competitors had recently made takeover offers for ECX, well in excess of its market price at the start of March ($1.97). First, in August 2018, SG Fleet (SGF) offered the equivalent of $2.52/share (this was rejected by ECX) and secondly, in December 2018, MMS offered the equivalent of $2.85/share (accepted by ECX). While we did not rely on these valuations, it did give us some comfort that we were holding an undervalued asset with an attractive yield (~8%) – unfortunately we were wrong.

In terms of contributors:

TNE (+8.4%) – There was little news over the month except for the company being upgraded by broker Bell Potter. TNE has been one of the markets strongest performers thus far this year primarily on the back of momentum in the technology sector. It was up 29.9% during the first quarter.

TCL (+5.9%) – There was little news other than an announcement that the CityLink Concession Deed Amendments for the West Gate Tunnel Project received the necessary parliamentary consents. TCL rallied primarily on the back of sharply lower bond yields which saw investor demand increase given its record as a consistent dividend payer and grower.

BHP (+5.5%) – Supply disruptions for the Vale dam disaster continued to reverberate through the market with updates suggesting that the impact may continue to be felt for years. Positive developments in trade negotiations between the US and China also helped.

BRG (+3.4%) – There were no news/updates during the month, however Breville continued to receive a strong bid from investors following a stellar earnings update in February.

Sector Exposure

Sector	Weight (%)
Consumer Discretionary	10.5%
Consumer Staples	6.1%
Energy	0.0%
Financials	18.7%
Health Care	8.3%
Industrials	14.8%
Information Technology	6.3%
Materials	9.8%
Real Estate	1.7%
Telecommunication Services	0.0%
Utilities	2.9%
CASH/LIQUIDITY	**20.9%**

Top 10 Holdings in alphabetical order

Company	Ticker
AMCOR LIMITED	AMC
APA GROUP	APA
ATLAS ARTERIA LTD	ALX
AUSTRALIA AND NEW ZELAND BANKING GROUP	ANZ
BHP BILLITON LIMITED	BHP
COMMONWEALTH BANK OF AUSTRALIA	CBA
CSL LIMITED	CSL
MACQUARIE GROUP LTD	MQG
TABCORP HOLDINGS	TAH
TRANSURBAN GROUP	TCL

Outlook

The first quarter of the year has yielded some incredible performances

Approximately 25% of S&P/ASX 200 companies saw their stock prices increase by over 20% during the first quarter. This seems amazing given the uninspiring earnings updates from most companies and the macro risks currently in play.

These outperforming companies can generally be categorized as either:

1. Resource and energy companies on higher commodity prices,
2. Fund managers which have rebounded with global markets,
3. Technology companies benefitting from momentum buying, or
4. High quality growth stocks which delivered strong earnings updates.

For the market to move meaningfully higher from here, either 1) these stocks will need to continue rallying despite elevated valuations, 2) banking stocks will need to rally strongly and/or 3) deep value stocks will need to turn around their recent underperformance.

Apart from some high quality 'offshore growers' continuing to perform strongly, we think the likelihood of the above scenarios playing out is low in the near-term given valuations, the upcoming federal election and elevated macro risks including domestic housing and retail spending.

Conclusion

Our views have changed little from last month and we continue to think that while Australian equities represent an attractive investment opportunity over the medium term, the near term risk/reward potential of the market remains weak. We remain overweight cash.

We continue to favor both offshore earners and quality yielders who can also deliver some enterprise and/or earnings growth over the medium term. We have positioned the portfolio for a weaker Australian dollar, relative domestic economic weakness, a lower domestic interest rate and an environment with increased political/regulatory risk.

Important Information